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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 17

[REG-140492-02]
RIN 1545-BD04

Definition of Solid Waste Disposal Facilities for Tax-Exempt Bond
Purposes

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of notice of proposed rulemaking; Notice of proposed
rulemaking; Notice of public hearing on proposed rulemaking.

SUMMARY: This document contains proposed regulations on the definition
of solid waste disposal facilities for purposes of the rules applicable
to tax-exempt bonds issued by State and local governments. These
proposed regulations provide guidance to State and local governments
that issue tax-exempt bonds to finance solid waste disposal facilities
and to taxpayers that use those facilities. This document also
withdraws the notice of proposed rulemaking that was published in the
Federal Register on May 10, 2004, proposes to remove certain existing
regulations that provide rules for determining whether a facility is a
solid waste disposal facility, and contains a notice of public hearing
on these proposed regulations.

DATES: Written or electronic comments must be received by December 15,
2009. Outlines of topics to be discussed at the public hearing
scheduled for January 5, 2010 must be received by December 17, 2009.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-140492-02), room
5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station,
Washington, DC 20044. Submissions may be hand delivered to:
CC:PA:LPD:PR Monday through Friday between the hours of 8 a.m. and 4
p.m. to CC:PA:LPD:PR (REG-140492-02), Courier's Desk, Internal Revenue
Service, 1111 Constitution Avenue, NW., Washington, DC, or sent
electronically via the Federal eRulemaking Portal at [http://
www.regulations.gov](http://www.regulations.gov) (IRS REG-140492-02). The public hearing will be
held in room 2615 at the Internal Revenue Building, 1111 Constitution
Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations,
Aviva Roth at (202) 622-3980; concerning submissions of comments, the
hearing, and/or to be placed on the building access list to attend the
hearing, e-mail Richard.A.Hurst@irscounsel.treas.gov.

SUPPLEMENTARY INFORMATION:

Background

This document proposes to amend the Income Tax Regulations (26 CFR
part 1) under section 142 of the Internal Revenue Code (Code) to

provide rules for determining whether a facility is a solid waste disposal facility under section 142(a)(6). This document also proposes to remove certain existing regulations that provide rules for determining whether a facility is a solid waste disposal facility and contains a notice of public hearing on these proposed regulations. On May 10, 2004, the IRS published a notice of proposed rulemaking (REG-140492-02) in the Federal Register (69 FR 25856) regarding when a facility qualifies as a solid waste disposal facility under section 142 (2004 Proposed Regulations). The 2004 Proposed Regulations proposed a new Sec. 1.142(a)(6)-1 of the Income Tax Regulations and would have removed existing Sec. 1.103-8(f)(2) and Sec. 17.1 of the temporary Income Tax Regulations on this subject (together, the Existing Regulations). Comments on the 2004 Proposed Regulations were received and a hearing was held on August 11, 2004. After consideration of the public comments, the IRS and the Treasury Department propose extensive changes to the 2004 Proposed Regulations. In order to allow the public an opportunity to comment with respect to these extensive changes, we are issuing these proposed regulations and holding a public hearing on these proposed regulations.

Explanation of Provisions

1. Introduction and Existing Regulations

In general, interest on State or local bonds is excludable from gross income

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under section 103(a). Under section 103(b), however, interest on private activity bond is excludable from gross income under section 103 only if the bond meets the requirements for a qualified bond under section 141(e) and other applicable requirements under section 103. Section 141(e) defines a qualified bond to include an exempt facility bond that meets certain requirements. Section 142(a) defines an exempt facility bond to mean any bond that is issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide an exempt facility specified in section 142(a). Section 142(a)(6) includes a solid waste disposal facility as one specified type of qualified exempt facility.

Section 1.103-8(f)(2)(ii)(a) of the Existing Regulations generally defines solid waste disposal facilities to mean any property or portion thereof used for the collection, storage, treatment, utilization, processing, or final disposal of solid waste. Section 1.103-8(f)(2)(ii)(b) of the Existing Regulations provides that the term solid waste has the same meaning as in former section 203(4) of the Solid Waste Disposal Act (42 U.S.C. 3252(4)), as quoted in Sec. 1.103-8(f)(2)(ii)(b), except that material will not qualify as solid waste unless, on the date of issue of the obligations issued to provide the facility to dispose of the waste material, it is property that is useless, unused, unwanted, or discarded solid material that has no market or other value at the place where the property is located (No-Value Test). Thus, under the Existing Regulations, if any person is willing to purchase property at any price, the property fails to constitute waste. By contrast, under Sec. 1.103-8(f)(ii)(B) of the Existing Regulations, if any person is willing to remove the property at his own expense but is unwilling to purchase it at any price, the material is waste.

Former section 203(4) of the Solid Waste Disposal Act, as quoted in Sec. 1.103-8(f)(2)(ii)(b) of the Existing Regulations, provides that the term solid waste means:

[g]arbage, refuse, and other discarded solid materials, including solid-waste materials resulting from industrial, commercial, and agricultural operations, and from community activities, but does not include solids or dissolved material in domestic sewage or other significant pollutants in water resources, such as silt, dissolved

or suspended solids in industrial waste water effluents, dissolved materials in irrigation return flows or other common water pollutants.

Section 1.103-8(f)(2)(iii)(c) of the Existing Regulations provides that a facility that disposes of solid waste by reconstituting, converting, or otherwise recycling it into material that is not waste also qualifies as a solid waste disposal facility if solid waste constitutes at least 65 percent, by weight or volume, of the total materials introduced into the recycling process. Such a recycling facility does not fail to qualify as a solid waste disposal facility under the Existing Regulations solely because it operates at a profit.

Section 17.1(a) of the Existing Regulations generally provides that, for mixed-use facilities that serve a solid waste disposal function and other functions, only the portion of the cost of the property allocable to the function of solid waste disposal qualifies as an eligible cost of a solid waste disposal facility. Section 17.1(a) of the Existing Regulations further provides that a facility that otherwise qualifies as a solid waste disposal facility will not be treated as having a function other than solid waste disposal merely because material or heat that has utility or value is recovered or results from the disposal process. Section 17.1(a) of the Existing Regulations provides that, when materials or heat are recovered, the waste disposal function includes the processing of those materials or heat that occurs in order to put them into the form in which the materials or heat are in fact sold or used, but does not include further processing that converts the materials or heat into other products.

Section 17.1(b) of the Existing Regulations provides that the portion of the cost of property allocable to solid waste disposal is determined by allocating the cost of the property between the property's solid waste disposal function and any other functions by any method that reasonably reflects a separation of costs for each function of the property, based on the facts and circumstances.

2. The 2004 Proposed Regulations

In light of the changes that have occurred in the waste recycling industry since the Existing Regulations were issued in the 1970s, the IRS and the Treasury Department issued Notice 2002-51 (2002-2 CB 131), which invited comments on issues concerning the application of section 142 to solid waste disposal facilities, including recycling facilities. After consideration of the public comments on the Notice, the IRS and the Treasury Department issued the 2004 Proposed Regulations. See Sec. 601.601(d)(2)(ii)(b).

The 2004 Proposed Regulations proposed to eliminate the No-Value Test for determining whether material is solid waste. Instead, the 2004 Proposed Regulations, retaining the definition of solid waste under former section 203(4) of the Solid Waste Disposal Act, provided that ``garbage, refuse and other discarded solid materials'' meant material that is solid and that is introduced into a final disposal process, conversion process, recovery process, or transformation process (as those terms were defined in the 2004 Proposed Regulations) unless such material fell within one of several categories of specifically excluded items. Included within the categories of specifically excluded items under the 2004 Proposed Regulations were: (1) Fossil fuels or other materials created for the principal purpose of converting the materials to heat, hot water, steam, or other useful energy, introduced into a conversion process; (2) precious metals introduced into a recovery process; (3) hazardous materials subject to final permit requirements under subtitle C of title II of the Solid Waste Disposal Act (as in effect on October, 22, 1986, the date of enactment of the Tax Reform Act of 1986); and (4) radioactive materials.

The 2004 Proposed Regulations provided that a facility is a solid waste disposal facility to the extent that the facility is: (1) Used to perform a solid waste disposal function, (2) used to perform a preliminary function, or (3) functionally related and subordinate

(within the meaning of Sec. 1.103-8(a)(3)) to a facility that is used to perform a solid waste disposal function or a preliminary function.

The 2004 Proposed Regulations further defined a solid waste disposal function as the processing of solid waste in (1) a final disposal process, (2) a conversion process, (3) a recovery process, or (4) a transformation process. A final disposal process was defined as the placement of material in a landfill or the incineration of material without any useful energy being captured. A conversion process was defined as a process in which material is incinerated and heat, hot water, or steam is created and captured as useful energy beginning with the incineration of material and ending at the point at which the latest of heat, hot water, or steam is created. A recovery process was defined as a process that starts with the melting or re-pulping of material to return the material to a form in which the material previously existed for use in the fabrication of an end product and ends immediately before the material is processed in the same or substantially the same way that virgin material is

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processed to fabricate the end product. With respect to such definition of recovery process, the 2004 Proposed Regulations further provided that if an end product is fabricated entirely from non-virgin material, the recovery process ends immediately before the non-virgin material is processed in the same or substantially the same way that virgin material is processed in a comparable fabrication process that uses only virgin material or a combination of virgin and non-virgin material. According to the 2004 Proposed Regulations, refurbishing, repair, or similar activities are not recovery processes. The IRS and Treasury Department reserved on the definition of transformation process.

The 2004 Proposed Regulations provided that a preliminary function is the collection, separation, sorting, storage, treatment, processing, disassembly, or handling of solid waste material that is preliminary and directly related to a solid waste disposal function unless for each year while the issue is outstanding, more than 50 percent, by weight or volume, of the total materials that result from the entire activity (both the part that is preliminary and directly related to a solid waste disposal function and the part that is not preliminary and directly related to a solid waste disposal function) is solid waste.

The 2004 Proposed Regulations further provided that if a facility is used to perform both (1) a solid waste disposal function or a preliminary function, and (2) another function, then the costs of the facility allocable to the solid waste disposal function or the preliminary function are determined using any reasonable method, based on all the facts and circumstances. This rule applies, for example, if a facility is used (1) to process solid waste in a recovery process, and (2) to perform another function that is neither a solid waste disposal function (because it does not process solid waste in a final disposal process, conversion process, recovery process, or transformation process) nor a preliminary function (because it is not preliminary and directly related to a solid waste disposal function). The 2004 Proposed Regulations also contained a special rule to determine the portion of the costs of property that are allocable to a solid waste disposal function if the property is used to perform a final disposal process, conversion process, recovery process, or transformation process and the inputs to the process consist of solid waste and material that is not solid waste. Under this special rule, the portion of the costs of property used to perform such a process that are allocable to a solid waste disposal function equals the lowest percentage of solid waste processed in the process in any year while the issue is outstanding. The percentage of solid waste processed in such a process for any year is the percentage, by weight or volume, of the total materials processed in the process that constitute solid waste for that year. If, however, for each year while the issue is outstanding, solid waste constitutes at least 80 percent, by weight or volume, of the total materials processed in the process, all of the

costs of the property used to perform the process are allocable to a solid waste disposal function.

3. Comments on the 2004 Proposed Regulations

In response to the 2004 Proposed Regulation, comments were received with respect to the definition of solid waste. Some commentators criticized the elimination of the No-Value Test from the definition of solid waste in the 2004 Proposed Regulations, while other commentators agreed with the deletion of the No-Value Test. Commentators suggested various changes to the proposed definition of solid waste. Other commentators suggested clarification that community waste qualifies as solid waste.

Comments also were received with respect to categories of items specifically excluded from the definition of solid waste under the 2004 Proposed Regulations. Some commentators suggested that the exclusion from solid waste for fossil fuels that are introduced into an energy conversion process is too broad because it excludes fossil fuels that are low-grade, such as waste coal that is not grown, harvested, produced, mined, or otherwise created for the principal purpose of converting material to useful energy. Other commentators suggested that solid waste introduced into an energy conversion process should include certain byproducts of typical agricultural operations that are not engaged in with the principal purpose of growing, harvesting, producing, or otherwise creating products to convert such products into useful energy. Commentators further suggested clarification of the exclusion from the definition of solid waste for precious metals introduced to a recycling process. Still other commentators further suggested the inclusion of hazardous waste and radioactive waste as solid waste.

Comments were received with respect to the various solid waste disposal processes. With respect to the final disposal process, some commentators suggested the inclusion of indefinite confinement of material within a final disposal process. With respect to the energy conversion process, commentators suggested including methods of creating energy besides combustion within an energy conversion process and expanding the scope of an eligible energy conversion process to include certain related processes. Another comment suggested disregarding small amounts of otherwise-ineligible fossil fuels and chemical and other additives.

Comments also were received with respect to mixed-input facilities that receive both solid waste material and other types of input. Commentators suggested an expansion of the scope of permitted mixed-input facilities to include an allowable amount of 35 percent or less of material that is not solid waste to be introduced to an energy conversion process or a recycling process without disqualifying those processes. Commentators also suggested measuring the allowable amount of non-solid waste input into a mixed-input facility based on the average percentage of inputs that are not solid waste over the life of the issue.

The IRS and Treasury Department have considered these comments, and the proposed regulations contained in this document implement a number of these recommendations.

4. Regulations Proposed in This Document

A. Solid Waste Disposal Facility

The proposed regulations define a solid waste disposal facility as any facility to the extent that it (1) processes solid waste in a qualified solid waste disposal process, (2) performs a preliminary function, or (3) is functionally related and subordinate (within the meaning of Sec. 1.103-8(a)(3)) to a facility which either processes solid waste in a qualified solid waste disposal process or performs a preliminary function.

B. Definition of Solid Waste

The proposed regulations eliminate the No-Value Test, as did the 2004 Regulations. The IRS and the Treasury Department have determined

that whether material has value, or value apart from recycling as one commentator suggested, is unadministrable. However, in response to the comments received with respect to the 2004 Proposed Regulations, the IRS and the Treasury Department have determined that a definition of solid waste is needed that takes into account

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the material itself and not only the process by which such material is to be disposed or recycled. Accordingly, the proposed regulations define solid waste as garbage, refuse, and other solid material, derived from any agricultural, commercial, consumer, or industrial operation or activity that is either used material or residual material and that is reasonably expected by the person who purchases or otherwise acquires such material to be introduced within a reasonable time after such purchase or acquisition in a qualified solid waste disposal process. While the type of disposal or recycling process does not affect the treatment of material as solid waste, the person acquiring such material must intend to place such materials into a qualified solid waste disposal process within a reasonable time after acquisition. Material that the acquiring party intends to store or resell to the general public is not solid waste under the proposed regulations.

Used material is defined in the proposed regulations as any material that has been used previously as an agricultural, commercial, consumer, or industrial product or as a component of any such product. It is the intention of the IRS and Treasury Department that this definition be interpreted broadly to encompass popularly understood uses of materials but that such definition should not apply to smaller products purchased by manufacturers and incorporated by such manufacturer into a larger product.

Residual material is defined in the proposed regulations as any residual byproduct or excess unused raw material that remains from the production of any agricultural, commercial, consumer, or industrial product, provided that material qualifies as residual material only to the extent that it constitutes less than five percent of the total material introduced into the production process and it has a fair market value that is reasonably expected to be lower than that of any product made in that production process. This definition is intended to encompass a wide range of products from waste coal to byproducts of typical agricultural operations, and is intended to further encourage innovation in the full use of all resources.

C. Specific Exclusions From the Definition of Solid Waste

The proposed regulations exclude from the definition of solid waste the following items: (1) Virgin material; (2) solids within liquids and liquid waste; (3) precious metals; (4) hazardous material; and (5) radioactive material. The definition of virgin material in the proposed regulations encompasses all raw materials except to the extent such material becomes remainder material. The proposed regulations further clarify that a material does not cease to be virgin material until it has been processed to a point where no further processing is expected.

The proposed regulations specifically exclude certain commonly-recognized precious metals from the definition of solid waste because recovery of these metals generally would take place with or without a recycling industry.

With respect to hazardous and radioactive waste, the statute and legislative history suggest that Congress intended to exclude hazardous waste and radioactive waste from solid waste. The statute treats qualified hazardous waste facilities separately as eligible exempt facilities under section 142(a)(10) in addition to solid waste disposal facilities under section 142(a)(6). In addition, the legislative history provides, in relevant part, that ``the conferees wish to clarify that solid waste does not include most hazardous waste (including radioactive waste).'' H. Rep. No. 99-841, 99th Cong. 2d. Sess (September 18, 1986), 1986-3 C.B. Vol. 4, at II-704. Accordingly, such items are specifically excluded from the definition of solid waste.

D. Qualified Solid Waste Disposal Process

The proposed regulations provide for three eligible types of solid waste disposal processes, including a final disposal process, an energy conversion process, and a recycling process. In order to provide flexibility for future innovation, absent an express restriction in the proposed regulations, a solid waste disposal function may employ any biological, engineering, industrial, or technological method.

Under the proposed regulations, a final disposal process includes the placement of solid waste in a landfill, the incineration of solid waste without capturing any useful energy, and the containment of solid waste with the reasonable expectation that the containment will continue indefinitely and that the solid waste has no current or future beneficial use.

To accommodate existing and new technologies, the description of an energy conversion process in the proposed regulations includes thermal, chemical, and other processes used to create and capture useful energy. The proposed regulations also permit 35 percent or less of the material introduced to an energy conversion process to be material other than solid waste to accommodate disposal processes that require the introduction of materials other than solid waste. In general, under the proposed regulations, an energy conversion process begins at the point of the first application of a process to create and capture useful energy and ends at the point at which the useful energy is first created or captured in the form of a first useful product (for example, the conversion of solid waste into useful steam energy). The proposed regulations generally do not include related processes in an energy conversion process because these processes are appropriately included in preliminary facilities and functionally related and subordinate functions.

In response to public comment and in further consideration of policy in support of recycling, the proposed regulations combine the concepts of recovery process and transformation process introduced in the 2004 Proposed Regulations into an eligible recycling process, which means a process for disposing of solid waste that reconstitutes, transforms, or otherwise processes the solid waste into a useful product. The recycling process begins at the point of the first application of a process to reconstitute or transform the solid waste into a useful product, such as decontamination, melting, re-pulping, shredding, or other processing of the solid waste to accomplish this purpose. The recycling process ends at the point of completion of production of the first useful product from the solid waste.

E. First Useful Product Principle

The proposed regulations provide guidance on the standard for determining the first useful product for purposes of the end point of an eligible energy conversion process and recycling process. For this purpose, the proposed regulations provide that the term useful product means a product that is useful for consumption in individual, commercial, industrial, or agricultural use and that could be sold for such use, whether or not actually sold. For this purpose, a useful product includes both a product useful to an individual or commercial consumer as an ultimate end-use product and a product useful to an industrial user as a material or input for processing in some stage of a manufacturing or production process to produce a different end-use product. Further, for this purpose, in the case of a continuous or integrated production process, the determination of when a useful product may result from such an integrated process may take into account operational constraints that affect the point in production when a useful product reasonably can be

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extracted or isolated and sold independently.

F. Mixed-Input Facilities

The proposed regulations expand the scope of permitted mixed-input facilities to include an allowable amount of 35 percent or less of material that is not solid waste to be introduced each year into an energy conversion process or a recycling process without disqualifying

those processes.

Proposed Effective Dates

In general, the proposed regulations will apply to bonds to which section 142 applies that are sold on or after the date that is 60 days after the date of publication of final regulations under section 142(a)(6) in the Federal Register. Issuers may apply this section to bonds sold before the date that is 60 days after publication of final regulations in the Federal Register.

Special Analysis

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for January 5, 2010 beginning at 10 a.m. in room 2615 of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by December 17, 2009. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these proposed regulations are Aviva M. Roth and Timothy L. Jones, Office of the Associate Chief Counsel (Financial Institutions and Products), Internal Revenue Service. However, personnel from other offices of the Treasury Department and the IRS participated in their development.

Withdrawal of Previous Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking (REG-140492-02) that was published in the Federal Register on May 10, 2004 (69 FR 25856), is withdrawn as of September 16, 2009.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 17

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Sec. 1.103-8 [Amended]

Par. 2. Section 1.103-8 is amended by removing paragraph (f)(2)(ii) and redesignating paragraph (f)(2)(iii) as (f)(2)(ii).

Par. 3. Section 1.142(a)(6)-1 is added to read as follows:

Sec. 1.142(a)(6)-1 Exempt facility bonds: solid waste disposal facilities.

(a) In general. This section defines the term solid waste disposal facility for purposes of section 142(a)(6).

(b) Solid waste disposal facility. The term solid waste disposal facility means a facility to the extent that the facility--

(1) Processes solid waste (as defined in paragraph (c) of this section) in a qualified solid waste disposal process (as defined in paragraph (d) of this section);

(2) Performs a preliminary function (as defined in paragraph (f) of this section); or

(3) Is functionally related and subordinate (within the meaning of Sec. 1.103-8(a)(3)) to a facility described in paragraph (1) or (2) of this section.

(c) Solid waste--(1) In general. Except to the extent excluded under paragraph (c)(2) of this section, for purposes of section 142(a)(6), the term solid waste means garbage, refuse, and other solid material derived from any agricultural, commercial, consumer, or industrial operation or activity if the material meets the requirements of both paragraph (c)(1)(i) and paragraph (c)(1)(ii) of this section.

(i) Used material or residual material. Material meets the requirements of this paragraph (c)(1) if it is either used material (as defined in paragraph (c)(1)(i)(A)) or residual material (as defined in paragraph (c)(1)(i)(B)).

(A) Used material. The term used material means any material that has been used previously as an agricultural, commercial, consumer or industrial product or as a component of any such product.

(B) Residual material. The term residual material means any residual byproduct or excess unused raw material that remains from the production of any agricultural, commercial, consumer, or industrial product, provided that material qualifies as residual material only to the extent that it constitutes less than five percent of the total material introduced into the production process and it has a fair market value that is reasonably expected to be lower than that of any product made in that production process.

(ii) Reasonably expected introduction into a qualified solid waste

disposal process. Material meets the requirements of this paragraph (c)(1)(ii) if it is reasonably expected by the person who purchases or otherwise acquires it to be introduced within a

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reasonable time after such purchase or acquisition into a qualified solid waste disposal process described in paragraph (d) of this section.

(2) Exclusions from solid waste. The following materials do not constitute solid waste:

(i) Virgin material. Solid waste excludes any virgin material except to the extent that it is a residual material. The term virgin material means material that has not been processed into an agricultural, commercial, consumer, or industrial product or a component of any such product. Further, for this purpose, material continues to be virgin material after it has been grown, harvested, mined, or otherwise extracted from its naturally occurring location and cleaned, divided into component elements, modified, or enhanced as long as further processing is required before it becomes an agricultural, commercial, consumer, or industrial product or a component of any such product.

(ii) Solids within liquids and liquid waste. Solid waste excludes any solid or dissolved material in domestic sewage or other significant pollutant in water resources, such as silt, dissolved or suspended solids in industrial waste water effluents, dissolved materials in irrigation return flows or other common water pollutants, and liquid or gaseous waste.

(iii) Precious metals. Solid waste excludes gold, silver, ruthenium, rhodium, palladium, osmium, iridium, platinum, gallium, and rhenium.

(iv) Hazardous material. Solid waste excludes any hazardous material that is disposed of at a facility that is subject to final permit requirements under subtitle C of title II of the Solid Waste Disposal Act as in effect on the date of the enactment of the Tax Reform Act of 1986 (which is October 22, 1986). See section 142(h)(1) of the Internal Revenue Code.

(v) Radioactive material. Solid waste excludes any radioactive material.

(d) Qualified solid waste disposal process. The term qualified solid waste disposal process means the processing of solid waste in a final disposal process (as defined in paragraph (d)(1) of this section), an energy conversion process (as defined in paragraph (d)(2) of this section), or a recycling process (as defined in paragraph (d)(3) of this section). Absent an express restriction to the contrary in this section, a qualified solid waste disposal process may employ any biological, engineering, industrial, or technological method.

(1) Final disposal process. The term final disposal process means either the placement of solid waste in a landfill, the incineration of solid waste without capturing any useful energy, or the containment of solid waste with a reasonable expectation that the containment will continue indefinitely and that the solid waste has no current or future beneficial use.

(2) Energy conversion process. The term energy conversion process means a thermal, chemical, or other process that is applied to solid waste to create and capture synthesis gas, heat, hot water, steam, or other useful energy. The energy conversion process begins at the point of the first application of such process. The energy conversion process ends at the point at which the useful energy is first created or captured in the form of a first useful product (as defined in paragraph (e) of this section), provided that, in all events, the energy conversion process ends before any transfer or distribution of synthesis gas, heat, hot water, steam, or other useful energy.

(3) Recycling process--(i) In general. The term recycling process means reconstituting, transforming, or otherwise processing solid waste into a useful product. The recycling process begins at the point of the first application of a process to reconstitute or transform the solid

waste into a useful product, such as decontamination, melting, repulping, shredding, or other processing of the solid waste to accomplish this purpose. The recycling process ends at the point of completion of production of the first useful product from the solid waste.

(ii) Refurbishment, repair, or similar activities. The term recycling process does not include refurbishment, repair, or similar activities. The term refurbishment means the breakdown and reassembly of a product if such activity is done on a product by product basis and if the finished product contains more than 30 percent of its original materials or components.

(e) First useful product. The term first useful product means the first product produced from solid waste that is useful for consumption in agricultural, consumer, commercial, or industrial operation or activity and that could be sold for such use, whether or not actually sold. A useful product includes both a product useful to an individual consumer as an ultimate end-use consumer product and a product useful to an industrial user as a material or input for processing in some stage of a manufacturing or production process to produce a different end-use consumer product. In the case of a continuous or integrated production process, the determination of when a useful product may result from such an integrated process may take into account operational constraints that affect the point in production when a useful product reasonably can be extracted or isolated and sold independently.

(f) Preliminary function. A preliminary function is a function to collect, separate, sort, store, treat, process, disassemble, or handle solid waste that is preliminary to and directly related to a qualified solid waste disposal process. A function qualifies as a preliminary function only if more than 50 percent of the total materials that result from the function is solid waste in each year that the issue is outstanding.

(g) Mixed-use facilities--(1) In general. Except as otherwise provided in paragraph (g)(2) of this section, if a facility is used for both a qualified solid waste disposal function (including a qualified solid waste disposal process or a preliminary function) and a nonqualified function, then the costs of the facility allocable to the qualified solid waste disposal function are determined using any reasonable method, based on all the facts and circumstances. See Sec. 1.103-8(a)(1) for allocation rules on amounts properly allocable to an exempt facility.

(2) Mixed inputs--(i) In general. Except as provided in paragraph (g)(2)(iii) of this section, for each qualified solid waste disposal process, the percentage of the costs of the property used for such process that are allocable to a qualified solid waste disposal process equals the average annual percentage of solid waste processed in that process while the issue is outstanding. The average percentage of solid waste processed in such process for any year is the average percentage, by weight or volume, of the total materials processed in that process that constitute solid waste for that year.

(ii) Special rule for mixed-input processes if at least 65 percent of the materials processed are solid waste. For each qualified solid waste disposal process, if the annual percentage of solid waste used in that process for each year that the issue is outstanding equals at least 65 percent of the materials used in that process, then all of the costs of the property used for such process are treated as allocable to a qualified solid waste disposal process. The percentage of solid waste used in such process for any year is the percentage, by weight or volume, of the total materials used in that process that constitute solid waste for that year.

(h) Examples. The following examples illustrate the application of this section:

Example 1. Nonqualified unused material--cloth. Company A takes wool and

weaves it into cloth and then sells the cloth to a manufacturer to manufacture clothing. The cloth is material that has not been used previously as an agricultural, commercial, consumer, or industrial product or as a component of any such product. Accordingly, the cloth is not solid waste.

Example 2. Residual material from refining of crude oil. Company B takes crude oil and refines it into various products, including finished motor gasoline, distillate fuel oil, and jet fuel. The balance of the crude oil remaining after this production process is in the form of a nonhazardous material which subsequently is used to make asphalt. This nonhazardous material constitutes less than 5 percent of the total crude oil that was introduced into the production process and it has a fair market value that is reasonably expected to be lower than that of any product produced in that oil refining process. The portion of the crude oil that remains after the refining process as the nonhazardous material is residual material within the meaning of paragraph (c)(1)(i)(B) of this section that qualifies as solid waste. The portion of the facility directly related to the production of asphalt from such residual material may be treated as a qualified solid waste disposal facility up to the point of the production of a first useful product (here asphalt) within the meaning of paragraph (e) of this section from the residual material.

Example 3. Residual material--waste coal. Company C mines coal. Less than 5 percent of ore mined is low quality byproduct of coal mining known as waste coal, which cannot be converted to energy under a normal energy-production process because the BTU content is too low. Waste coal has a lower fair market value than any product produced in the coal mining operation. Waste coal is solid waste because it is residual material within the meaning of paragraph (c)(1)(i)(B) of this section and Company C reasonably expects to introduce the waste coal into a solid waste disposal process. A facility that converts this waste coal into energy may be treated as a solid waste disposal facility.

Example 4. Virgin material--logs. Company D cuts down trees and sells the lumber to another company, which further processes the lumber into paper. In order to facilitate shipping, Company D cuts the trees into uniform logs. The trees are not solid waste because they are virgin materials within the meaning of paragraph (c)(2)(i) of this section. The division of such trees into uniform logs does not change the status of the trees as virgin material.

Example 5. Qualified solid waste disposal process--landfill. Company E plans to construct a landfill. The landfill will not be subject to the final permit requirements under subtitle C of title II of the Solid Waste Disposal Act (as in effect on the date of enactment of the Tax Reform Act of 1986). Company E expects that the landfill will be filled entirely with material that will qualify as solid waste within the meaning of paragraph (c) of this section. Company E does not expect that a significant portion of the material placed in the landfill will be virgin materials or precious metals. Placing solid waste into a landfill is a qualified solid waste disposal process. The landfill is a qualified solid waste disposal facility.

Example 6. Qualified solid waste disposal process--recycling tires. Company F owns a facility that converts old, previously used tires into roadbed material. The used tires are used material within the meaning of paragraph (c)(1)(i)(A) of this section that qualifies as solid waste. Between the introduction of the old tires into the roadbed manufacturing process and the completion of the roadbed material, the facility does not create any interim useful products. The process for the manufacturing of the roadbed material from the old tires is a qualified solid waste disposal process as a recycling process and the facility that converts the tires into roadbed material is a qualified solid waste disposal facility. This conclusion would be the same if the recycling process took place at more than one plant.

Example 7. Nonqualified refurbishment. Company G purchases used cars and restores them. This restoration process includes disassembly, cleaning, and repairing of the cars. Parts that cannot be repaired are replaced. The restored cars contain at least 30 percent of the original pieces. While the cars are solid waste, the refurbishing process is not a qualified solid waste disposal process. Accordingly, Company G's facility is not a qualified solid waste disposal facility.

Example 8. Qualified solid waste disposal facility--first useful product rule--paper recycling. Company H employs an integrated process to re-pulp discarded magazines, clean the pulp, and produce retail paper towel products. Operational constraints on Company H's process do not allow for reasonable extraction, isolation, and sale of the cleaned paper pulp independently without degradation of the pulp. Company H further processes the paper pulp into large industrial-sized rolls of paper which are about 12 feet in diameter. At this point in the process, Company H could either sell such industrial-sized rolls of paper to another company for further processing to produce retail paper products or it could produce those retail products itself. In general, paper pulp is a useful product that is bought and sold on the market as a material for input into manufacturing or production processes. The discarded magazines are solid waste because they are used material within the meaning of paragraph (c)(1)(i)(A) of this section. Company H's facility is engaged in a recycling process within the meaning of paragraph (d)(3) of this section to the extent that it repulps and cleans the discarded magazines generally and further to the extent that it produces industrial-sized rolls of paper under the particular circumstances here. Specifically, taking into account the operational constraints on Company H's facility that limit its ability reasonably to extract, isolate, and sell the paper pulp independently, the first useful products within the meaning of paragraph (e) of this section from Company H's recycling process are the industrial-sized rolls of paper. The portion of Company H's facility that produces industrial-sized rolls of paper is a qualified solid waste disposal facility, and the portion of Company H's facility that further processes the industrial-sized rolls of paper into retail paper towels is not a qualified solid waste disposal facility. Further, if the operational characteristics of Company H's facility allowed for reasonable extraction, isolation, and sale of the paper pulp independently, the first useful product would be the paper pulp and the portion of Company H's facility that cleans and re-pulps the magazines before processing in the paper machine to produce industrial-sized rolls of paper would be a qualified solid waste disposal facility.

Example 9. First useful product rule--energy conversion process. Company I receives solid waste from a municipal garbage collector. Company I burns that solid waste in an incinerator to remove exhaust gas and to produce heat. Company I further processes the heat in a heat exchanger to produce steam. Company I further processes the steam to generate electricity. The first useful product in this process is the useful energy in the form of steam. The facilities used to burn the solid waste and then capture the steam as useful energy are qualified solid waste disposal facilities because they process solid waste in an energy conversion process. The generating facilities used for further processing of the steam to create electricity do not engage in the energy conversion process and are not qualified solid waste disposal facilities.

Example 10. Preliminary function. Company J owns a paper mill. At the mill, logs from nearby timber operations are processed through a machine that removes bark. The stripped logs are used to manufacture paper. The stripped bark represents less than 5 percent of the logs processed into paper and has a lower fair market value than any product produced from the paper mill. The stripped bark falls onto a conveyor belt that transports the bark to a storage bin that is used to store the bark briefly until Company J feeds the bark into a boiler. The conveyor belt and storage bin are used only

for these purposes. The boiler is used only to create steam by burning the bark, and the steam is used to generate electricity. The stripped bark is solid waste because it is residual material within the meaning of paragraph (c)(1)(i)(B) of this section and because Company J expects to introduce the bark into a conversion process within a reasonable period of time. The creation of steam from the stripped bark is an energy conversion process that starts with the incineration of the stripped bark. The energy conversion process is a qualified solid waste disposal process. The conveyor belt performs a collection activity that is preliminary and that is directly related to the solid waste disposal function. The storage bin performs a storage function that is preliminary and that is directly related to the solid waste disposal function. Thus, the conveyor belt and storage bin are solid waste disposal facilities. The bark removal process is not a preliminary function because it is not directly related to the energy conversion process and it does not become so related merely because it results in material that is solid waste.

Example 11. Mixed-input facility. Company K owns an incinerator financed by an issue and uses the incinerator exclusively to burn coal and solid material to create steam that is used to generate electricity.

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Each year while the issue is outstanding, 40 percent by volume and 45 percent by weight of the solid material that Company K processes in the conversion process is coal. The remainder of the solid material is either used material or residual material within the meaning of paragraph (c)(1)(i) of this section. Sixty percent of the costs of the property used to perform the energy conversion process are allocable to a solid waste disposal function.

Example 12. Mixed-function facility. Company L owns and operates a facility financed by an issue and uses the facility exclusively to sort damaged bottles from undamaged bottles that may be re-used. The damaged bottles are directly introduced into a process that melts them for use in the fabrication of an end product. The damaged bottles are solid waste within the meaning of paragraph (b)(1) of this section, and the melting process is a qualified solid waste disposal process as a recycling process within the meaning of paragraph (c)(3) of this section. Refilling the bottles is not a qualified solid waste disposal process. Each year while the issue is outstanding, more than 50 percent, by weight or volume, of all of the bottles that pass out of the sorting process are damaged bottles that are processed in a recycling process. The sorting facility performs a preliminary function, but it also performs another function. The costs of the sorting facility allocable to the preliminary function are determined using any reasonable method, based on all the facts and circumstances.

(i) Effective Dates--(1) In general. This section applies to bonds to which section 142 applies that are sold on or after the date that is 60 days after publication of final regulations in the Federal Register.

(2) Elective retroactive application. Issuers may apply this section to bonds sold before the date that is 60 days after publication of final regulations in the Federal Register.

PART 17--TEMPORARY INCOME TAX REGULATIONS UNDER 26 U.S.C. 103C

Par. 4. The authority citation for part 17 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Sec. 17.1 [Removed]

Par. 5. Section 17.1 is removed.

Linda M. Kroening,
(Acting) Deputy Commissioner for Services And Enforcement.
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